

# **EXHIBIT B**

# **EXHIBIT B**



APPEARANCES:

FOR THE APPELLANTS: DEAN T. KIRBY, JR., Esq.  
Kirby & McGinn, A.P.C.  
600 "B" Street  
San Diego, California 92101-8509

FOR THE APPELLEES: For the Appellees, Debtors:  
JEANETTE MCPHERSON, Esq.  
Schwartz & McPherson  
2850 South Jones Blvd, Suite 1  
Las Vegas, Nevada 89146  
Usdcfilings@s-mlaw.com  
and  
ANNETTE W. JARVIS, Esq.  
PEGGY HUNT, Esq.  
Ray Quinney & Nebeker PC  
36 S. State Street, Suite 1400  
Salt Lake City, Utah 84111  
ajarvis@rqn.com

For the Committee of Holders of  
Executory Contract Rights of USA  
Commercial Mortgage Company:  
GREGORY E. GARMAN, Esq.  
Gordon & Silver, LTD.  
3960 Howard Hughes Parkway, 9th Floor  
Las Vegas, Nevada 89109  
Geg@gordonsilver.com

For Equity Security Holders of USA  
Capital Diversified Trust Deed Fund:  
MARC A. LEVINSON, Esq.  
Orrick, Herrington & Sutcliffe, LLP  
400 Capitol Mall, Suite 3000  
Sacramento, California 95814-4497  
Malevinson@orrick.com  
and  
ANNE M. LORADITCH, Esq.  
Beckley Singleton, Chtd.  
530 Las Vegas Blvd.  
Las Vegas, Nevada 89101  
Aloraditch@beckleylaw.com

(Continued)

APPEARANCES:

FOR THE APPELLEES:

For Jones Vargas Direct Lenders:  
JANET L. CHUBB, Esq.  
Jones Vargas  
100 W. Liberty Street, 12<sup>th</sup> Floor  
Reno, Nevada 89501  
[Tbw@jonesvargas.com](mailto:Tbw@jonesvargas.com)

For Official Committee of Equity  
Security Holders of USA Capital  
First Trust Deed Fund:  
CANDACE C. CARLYON, Esq.  
Shea & Carlyon, Ltd.  
228 S. Fourth Street, 1st Floor  
Las Vegas, Nevada 89101  
[ccarlyon@sheacarlyon.com](mailto:ccarlyon@sheacarlyon.com)

For Unsecured Creditors Committee of  
USA Commercial Mortgage Company:  
DARREN T. BRENNER, Esq.  
Lewis & Roca LLP  
3993 Howard Hughes Pkwy., Suite 600  
Las Vegas, Nevada 89109  
[dbrenner@lrlaw.com](mailto:dbrenner@lrlaw.com)

For Lenders Protection Group:  
ALAN R. SMITH, Esq.  
KEVIN DARBY, Esq.  
Law Offices of Alan R. Smith  
505 Ridge Street  
Reno, Nevada 89501  
[Mail@asmithlaw.com](mailto:Mail@asmithlaw.com)

1 PROCEEDINGS BEGAN AT 10:35 A.M.

2 (Court's called to order)

3 JUDGE JONES: Good morning. Thank you. Please be  
4 seated.

5 We're here in --

6 JUDGE PRO: They're stunned.

7 [Laughter]

8 JUDGE JONES: -- in USA Commercial -- or rather, I'm  
9 sorry, Mortgage. Let me explain briefly what we're doing  
10 before we call for appearances.

11 We have three notices of appeal in this series of  
12 cases. They're all from the same order, of course, but three  
13 different notices, and to some extent they overlap in legal  
14 issues but they do have separate legal issues.

15 In normal course, the way an appeal referred back  
16 from the Bankruptcy Appellate Panel of the District Court  
17 works is, is by rotation, by random draw the judges are  
18 assigned one of those appeals with one judge hearing. In this  
19 case we have three notices of appeal. And in normal course,  
20 Judge Hunt was assigned the first one. He reassigned it to me  
21 briefly, at least for purposes of hearing the motions. He was  
22 otherwise engaged. Judge Pro received the second one; and I  
23 received the third one, by assignment. Again, Judge Pro  
24 assigned to me, temporarily, his case at least for purposes of  
25 hearing an emergency motion.

1           We have considered -- or contemplated between  
2 ourselves a little bit of a different procedure, and that is,  
3 potentially hearing these by way of a panel. Be ultimately  
4 the merits as opposed to these early motions. Rather than  
5 consolidating them, I think we would clearly have the  
6 discretion to consolidate them since they do have overlapping  
7 issues and they do have the -- they are an appeal from the  
8 self same -- one and the same order, confirming the plan.

9           They do have dissimilar issues in some respects and  
10 for that reason I think we also had the discretion not to  
11 consolidate them, but I believe what we've talked about,  
12 haven't decided yet, but what we've talked about is not  
13 consolidating the appeals but simply hearing them at the same  
14 time. And, therefore, sitting together as a panel of judges  
15 to hear them. It would be under that authority and analysis  
16 that we would hear them as a panel. If we did that and choose  
17 to do that, we would certainly issue one single opinion most  
18 likely which would be filed in each case, each unconsolidated  
19 appeal.

20           There is also discretion under the rules for the  
21 judges to entertain a case in en banc fashion. The District  
22 Court has done that previously in other cases. That wouldn't  
23 be the authority invoked here, but it would really be  
24 unconsolidated cases but being heard at the same time by a  
25 panel of judges who were randomly selected and picked for the

1 cases.

2 It's for that reason that I've invited Judge Pro  
3 to come out, since there is being addressed here today  
4 emergency motions in two of these appeals which would dispose  
5 of the appeals. They'd be dispositive rulings if the motions  
6 are granted and so I invited him and he's graciously agreed to  
7 come out and sit and listen to these same issues.

8 And, of course, I defer to him as -- really as the  
9 presiding judge. He's the senior and by far the older --

10 JUDGE PRO: Definitely older. Definitely older.

11 [Laughter]

12 JUDGE JONES: It's for that reason that we are  
13 appearing here as two judges on the panel.

14 I remind you, before I deferred to him as Presiding  
15 Judge, to call the case and ask please for your appearances.

16 I remind you that this is an appellate record.  
17 It's not like a trial factual record. No evidence can be  
18 proffered here. It's simply a record of your oral arguments  
19 on appeal. The Court certainly would not be making any  
20 findings of fact, as opposed to a ruling on the law as an  
21 appellate ruling.

22 So, reminding you that nature of the record being  
23 created here.

24 Let me defer please to Judge Pro, presiding.

25 JUDGE PRO: Thank you, Judge. You're too kind in

1 that regard, and it is simply because I am the elder of the  
2 Judges. But I really appreciate Judge Jones' approach to this  
3 and he did raise the issue with me and I thought, you know, it  
4 would be an interesting -- interesting way to consider these  
5 matters and so I was delighted to join him this morning -- or  
6 am delighted to join him this morning to hear your arguments  
7 on the two pending motions.

8 The cases are 2:07-Civil-72-RCJ, the Lenders  
9 Protection Group, et al. versus USA Commercial; and  
10 In Re: United Commercial Mortgage Company, Debt Acquisition  
11 Company versus United Commercial Mortgage, and that is  
12 07-CV-160-RCJ.

13 Counsel, perhaps it would be helpful if you state  
14 your appearances for the record. Let me begin with counsel  
15 for the appellee debtors, who are the movants in this case  
16 with respect to the two emergency motions to dismiss the  
17 appeal.

18 MS. McPHERSON: Good morning, Your Honors. Jeanette  
19 McPherson of Schwartz & McPherson Law Firm, and Annette  
20 Jarvis of Ray Quinney & Nebeker on behalf of the appellee  
21 debtors.

22 JUDGE PRO: Thank you, counsel. And on behalf of  
23 the appellants?

24 MR. SMITH: Good morning, Your Honor. Alan Smith  
25 representing the Lenders Protection Group.



1 JUDGE PRO: Thank you, Mr. Smith.

2 MR. KIRBY: Dean Kirby, Kirby & McGinn, for Debt  
3 Acquisition Company of America.

4 JUDGE PRO: Thanks, Mr. Kirby.

5 And, Ms. Chubb?

6 MS. CHUBB: Good morning, Your Honor. Janet Chubb  
7 of Jones Vargas for the Jones Vargas Direct Lenders. But if  
8 you'd like, I'd be happy to read every one of my clients'  
9 names onto the record here, since that seems to be an issue.  
10 We have of course attached it in our 2019 statement so maybe  
11 you don't think that's necessary.

12 JUDGE PRO: No, you don't need to reread that at  
13 this time.

14 MS. CHUBB: Okay.

15 JUDGE PRO: All right.

16 MS. CHUBB: Thank you.

17 JUDGE PRO: Thank you.

18 JUDGE JONES: I think we do have one party on the  
19 phone, an associate of Mr. Smith, who's been given permission  
20 to listen only, not -- he's not going to argue.

21 MR. SMITH: That's correct.

22 JUDGE JONES: Why don't you -- we ought to call for  
23 him.

24 JUDGE PRO: Counsel, can -- I'm sorry, I didn't know  
25 who was on the line. But can you hear me?

1 MR. DARBY: Yes, Your Honor. This is Kevin Darby of  
2 the law offices of Alan R. Smith, also on behalf of appellant,  
3 The Lenders Protection Group.

4 MR. PRO: All right. Thank you. Thank you very  
5 much.

6 Anyone else on the phone? All right. Great.

7 Well, Judge Jones, if you agree, why don't we begin,  
8 then, with -- Ms. Jarvis, are you going to present argument on  
9 behalf of appellee debtors?

10 MS. JARVIS: On the calendar first, Your Honor, is  
11 our motion to dismiss the appeals of The Lender Protection  
12 Group and the Jones Vargas appellants, and so I will address  
13 that first.

14 Let me first address the need for an expedited  
15 hearing that was raised, unless Your Honors don't want me to  
16 do that, but let me -- there was some evidence presented --  
17 it was actually inadmissable hearsay evidence from a  
18 declaration of Ms. Kancholoski [phonetic] saying there is no  
19 need for this emergency hearing because there's a licensing  
20 issue. And we actually filed last night in Bankruptcy Court,  
21 an emergency motion to resolve this issue through having the  
22 debtors act as a sub-servicer pending the ability to get a  
23 license.

24 There was also a declaration of Mr. Cooney  
25 [phonetic] of Silver Point --

1 JUDGE JONES: I'm sorry. I apologize for  
2 interrupting. Repeat that. I didn't quite understand. You  
3 believe that's mooted because why?

4 MS. JARVIS: Well, I believe that that's not a  
5 reason -- what was argued is that we don't need this  
6 expedited hearing because we can't close this transaction  
7 anyway by the 16<sup>th</sup> because we have a licensing problem with  
8 the state mortgage lending division. And what we did last  
9 night was file an emergency motion in the Bankruptcy Court to  
10 allow the debtors to act as a sub-servicer pending the  
11 resolution of that. So that does not mean that we don't need  
12 this closed because we can -- you know, if we can deal with  
13 these issues we can close this, you know, over that issue  
14 before the 16<sup>th</sup>.

15 The second issue that was raised by The Lenders  
16 Protection Group, that we don't -- didn't need an expedited  
17 hearing, was based on a declaration from Mr. Cooney of Silver  
18 Point. Silver Point was also a bidder at the trial court.  
19 However, they specifically refused on the record to be a  
20 backup bidder, and his -- while his declaration says they're  
21 interested, there is no commitment and no requirement to close  
22 at the price that we currently have which is a 67-million-  
23 dollar sale. And in fact Silver Point was the stalking horse  
24 bidder at a 46-million-dollar bid.

25 So there was a huge, you know, difference. And

1 while they came up during the auction, they are not a bound  
2 [sic] bidder. So that is also not a reason for -- for us not  
3 needing an expedited hearing.

4 JUDGE JONES: If I may, I do have a couple questions  
5 on this emergency issue.

6 MS. JARVIS: Yes.

7 JUDGE JONES: And that's the finality of the sale  
8 order, in any event. I asked these same kind of questions  
9 when we were here on the motion to strike the Bankruptcy  
10 Appellate Panel's stay. And so I need to ask those again.

11 363(m), of course, gives a special status to a sale  
12 order. If you don't get a stay, pending appeal, the order for  
13 all intents and purposes is final. It can't be undone. The  
14 appellate court may provide another remedy. If they can't, of  
15 course, then the appeal ought to be dismissed as moot. But  
16 the order itself -- the sale and the sale provisions cannot be  
17 undone.

18 So my question pertains to that just a little bit.  
19 You have the ability to effect, according to the clear  
20 bankruptcy law as I understand it, to effect a sale under  
21 363(m) either by a sale order of the Court, after notice  
22 and hearing or you can effect it in an order confirming a  
23 plan.

24 And it would be my understanding, you'll correct me  
25 if I'm wrong, but 363(m) would apply to either kind of an

1 order. So, for example, if we have an order here confirming  
2 a plan and it contains 363 sale approval, and it contains  
3 terms and conditions that are approved, while the appeal  
4 itself could continue relating to a plan, that portion of the  
5 order that approves the plan, including any terms and  
6 conditions relative to the sale, would, in essence, be final  
7 with respect to the sale. No portion of the sale, or those  
8 terms and conditions could be overturned by the appellate  
9 court even if it agreed with the appeal or the appeal issues  
10 raised.

11 So I have to ask you that question again. Is that  
12 not the case here? Do we not, subsumed in the order  
13 confirming the plan, have a sale order approving -- and not  
14 only approving the sale, but approving certain terms and  
15 conditions of the sale which, in essence, becomes final, at  
16 least with respect under 363(m) to the ability of the  
17 appellate court in any respect going to that sale for those  
18 terms and conditions.

19 MS. JARVIS: We do, Your Honor, have incorporated in  
20 the confirmation order a 363(m) finding. The sale was done  
21 pursuant to 363 and 1123. 1123 does allow for 363, in  
22 essence, to be brought into a confirmation -- a plan and  
23 confirmation order, and that is the way we provided for that.  
24 So we did get a 360(m) finding -- a 363(m) finding. And that  
25 would allow the buyer to close.

1           The problem we have, is that the reason that this  
2 sale was not done independently of a plan is there were a lot  
3 of loose ends that needed to be wrapped up. And when you go  
4 through the asset purchase agreement they're issues that were  
5 vast and maybe even, you know, only possible in getting a plan  
6 con -- a plan confirmed. And as part of the bargaining for  
7 that, they bargained for not just a 363(m) finding, but a  
8 final order confirming the plan. And that order had to be  
9 final by the 16<sup>th</sup> of February or they have the opportunity to  
10 opt out of the sale without penalty.

11           JUDGE JONES: Now, there's a couple of problems with  
12 following your emergency analysis, and that is of course, even  
13 if we grant your motions -- I mean I granted the motion with  
14 respect to the appeal that I thought was pretty clear.

15           MS. JARVIS: Yeah.

16           JUDGE JONES: The equity holders, because of the  
17 proof and no contradicting proof that in fact the debtor was  
18 insolvent, the equity holders simply did not have standing  
19 under current law to appeal the confirmation of a plan that  
20 cancels their equity shares.

21           These cases are a little bit different, but  
22 certainly even in that appeal and as suggested here, even if  
23 we grant your motion they have 30 days to file a notice of  
24 appeal to the circuit. If that's the interpretation of non  
25 final order that any appeal is pending, aren't you just dead

1 in the water anyway?

2 MS. JARVIS: Well, Your Honor, I think -- I mean, it  
3 is problematic and we are aware of that. I do think that we  
4 would have an argument if we get these appeals dismissed.  
5 That for all practical purposes, we've complied with that at  
6 this moment. And that is certainly what we would argue. You  
7 know, technically, you're correct because they do have the  
8 opportunity to appeal further to the Circuit. But we are  
9 trying to bring ourselves as close -- as much into compliance  
10 with that and the ability to raise and argue that prior to the  
11 date. And that is why we feel like we need this emergency  
12 hearing and the ability to try to resolve these appeals at  
13 least, at this level.

14 JUDGE PRO: So the 16<sup>th</sup> is not really the drop-dead  
15 date? It's what's contemplated, but there is some forbearance  
16 by Compass by --

17 MS. JARVIS: No, there is no forbearance. It is  
18 drop-dead date. I mean, on the 16<sup>th</sup>, if we do not have final  
19 orders or cannot argue that we have, you know, final orders,  
20 then they do have the opportunity, if they want to, to refuse  
21 to close.

22 JUDGE PRO: Right.

23 MS. JARVIS: Yes.

24 JUDGE JONES: One last question in this regard is,  
25 what would be final under 363(m) if that's the interpretation



1 we take and if -- and if you -- if you use that as a basis to  
2 argue with your buyer that you really must close? Does 363(m)  
3 make your sale final? What would be final? There are terms  
4 and conditions approved by Judge Riegler. Those terms and  
5 conditions, for example, include pretty specific language  
6 "sold free and clear of any claim," not in exact language but,  
7 in essence, a claim of prior breach by the debtors that would  
8 give rise to the right of termination of -- for collection  
9 service. Am I incorrect that thinking that at least those  
10 terms would be included in a 363(m) prohibition? Are there  
11 any other terms or conditions that are critical to the buyer  
12 that would not -- you think would not be necessary, therefore  
13 this emergency claim?

14 MS. JARVIS: Well, I think, Your Honor, part of the  
15 compromise that was reached in the plan -- included in the  
16 plan with The Direct Lenders and USA Commercial Mortgage that  
17 was confirmed, has terms in it where there is an agreement  
18 basically, you know, with respect to the loan servicing  
19 agreements being transferred. You know, under 363, there is  
20 an agreement with respect to, you know, certain rights and  
21 claims that could be asserted against Compass.

22 So, while if we're placed in that position we  
23 certainly are going to argue, you know, 363(m) does it.  
24 There are other issues that are included in these compromises  
25 in the plan that are resolved, and with respect to prepaid



1 interest, which is something the buyer now has to pay back to  
2 us.

3 JUDGE JONES: And would you explain that just  
4 briefly? This was a last minute compromise at the time of  
5 confirmation, trying to reach compromise with some of the  
6 Direct Lender classes. Something was reserved back from the  
7 sale. And what was that something?

8 MS. JARVIS: Yeah. Well, there are actually two  
9 issues. There was the general compromise which is in the  
10 plan, that the class voted for, the Class A5 Direct Lenders  
11 class voted for.

12 JUDGE JONES: We give up a right to a full 100  
13 percent of our future collections to allow recoupment, if you  
14 will, of some of the monies that were paid to us improperly,  
15 pre-petition or post-petition.

16 MS. JARVIS: That's generally the case. Right.  
17 There were certain rights given up by the debtor, rights to  
18 try to recharacterize the Direct Lenders into all one pot.

19 JUDGE JONES: That's the general compromise?

20 MS. JARVIS: Right. And also, you know, to not  
21 contest the recoupment, you know, that was done with respect  
22 to the prepaid interest. They then received back, as a  
23 compromise, they were not charged for administrative expenses,  
24 other than for the 600,000 -- 605,000 that was paid to the  
25 Direct Lenders Committee. So there were compromises back and

1 forth.

2 JUDGE JONES: So out of that 2 percent, they're not  
3 going to be charged for any of the other administrative costs  
4 of the bankruptcy?

5 MS. JARVIS: No. That was remitted back or is --  
6 will be remitted back as part of that compromise. So that was  
7 the general compromise.

8 Then there was a specific compromise that was done  
9 at the confirmation because the issue of what free and clear  
10 means, in terms of being sold, and some of the issues that  
11 were raised by these parties that were objecting as to, well,  
12 we want to reserve our rights to be able to terminate the  
13 servicing agreement if there were breaches or a basis for  
14 doing that, based on what the debtor did pre-petition.

15 So there was a last minute compromise that was  
16 offered and, in fact it is in the record, Your Honor. It was  
17 done on the record at the confirmation hearing. It is on the  
18 -- in the transcript on the 19<sup>th</sup> of December, where Mr. Davis  
19 who represents Compass, goes through and says:

20 "Your Honor, we've -- you know, we've had some  
21 lengthy discussions about the types and claims" -- I'm  
22 quoting now from the transcript -- "of interest that we  
23 would take free and clear of. During the break we had  
24 discussions with counsel for the Direct Lenders Committee  
25 and I think we have reached agreement on that. I would

1 just like to advise Your Honor of how we think we've  
2 resolved that."

3 And then Mr. Davis goes to explain that they will  
4 agree, that they will not take free and clear of certain  
5 rights. So, in order words, it was a concession that Compass  
6 made at the confirmation hearing to try to resolve some of  
7 these issues.

8 JUDGE JONES: Just, in general, summarize it. What  
9 will they not take free and clear?

10 MS. JARVIS: They agreed that with respect to the  
11 rights of these -- of Direct Lenders, to be able to change  
12 servicers based on a breach of the servicer, and obtaining --

13 JUDGE JONES: So they -- did they preserve the right  
14 to terminate, based upon breaches of the debtor before the  
15 sale?

16 MS. JARVIS: Yes. That's correct.

17 JUDGE JONES: Okay.

18 MS. JARVIS: So if they had a matured breach and an  
19 ability to change servicers, as of the time the petition was  
20 filed --

21 JUDGE JONES: So, for example, if you had a \$200,000  
22 payoff and it went into the commingled account and it never  
23 got paid over to that particular Direct Lender, that Direct  
24 Lender could still say that was a breach that authorizes me to  
25 terminate this servicing agreement with the buyer.

1 MS. JARVIS: Right. The provision also requires  
2 though that you have to have 51 percent of the lenders in a  
3 loan because these loans -- some of them -- there are hundreds  
4 of lenders in loans. A lot of them have 300 --

5 JUDGE JONES: So a normal provision. Of course, a  
6 majority of the -- of the owners have to agree to terminate  
7 that service

8 MS. JARVIS: Right. So in this compromise he  
9 acknowledged that this could be done, that this would be  
10 preserved and it would not be free and clear of this right as  
11 long as these rights were asserted within a certain period of  
12 time, you know, and it would be determined by the Bankruptcy  
13 Court then, as to whether -- whether they had a right to  
14 change servicers.

15 JUDGE JONES: Okay.

16 MS. JARVIS: So this was a concession. It wasn't,  
17 you know, something that was further imposed. It was actually  
18 a benefit to The Direct Lenders. And this --

19 JUDGE JONES: I think I understand. That's all I  
20 had with regard to --

21 MS. JARVIS: Well, let me just mention one other  
22 thing in that respect that you need to understand, you know,  
23 there was at the end of his explaining this, Mr. Merola, who  
24 represents the First Trust Deed Committee did say:

25 "You know, Your Honor, on behalf of the seller I

1 would like to thank Compass -- because First Trust Deed  
2 is one of the sellers -- for timely addressing these very  
3 complicated issues. That's an enormous concession for a  
4 group like that to make."

5 This was done on the record and no one objected to  
6 this compromise. So there were no objections made to this --  
7 this concession on the record. And that, Your Honor, is of  
8 course one of our arguments, that since there were no  
9 objections made this is not a proper issue to appeal, because  
10 they didn't preserve their rights below.

11 Shall I turn now to the substance of The Lender  
12 Protection Group appeal -- or motion to dismiss?

13 As I read the response, The Lender Protection Group  
14 has appeared to limit it mainly to two issues, and so I'll  
15 address those issues.

16 Now, in a reply brief that we did file last night,  
17 we did address all of the standing issues with respect to all  
18 the issues that they raised in their -- their issues on  
19 appeal. But in their response they, you know, as I read it,  
20 limited it to these two issues, and so -- so I will address  
21 those issues.

22 And these two issues concern, first, the compromises  
23 in the plan and whether that could be done without an  
24 adversary proceeding. And the compromise that they're talking  
25 about is this prepaid interest, the recoupment, you know, of

1 the prepaid interest and all the back and forths that go with  
2 this Direct Lender compromise.

3 Then the second is, whether the loan servicing  
4 agreements could be transferred under 363 as non-executory  
5 contracts as determined by the trial court or whether these  
6 contracts were executory and had to be cured prior to  
7 transfer.

8 First with respect to the compromise issue, and I'll  
9 also address our second standing issue last, which is the  
10 issue of whether the notice of appeal was properly filed.

11 With respect to the compromise issue which involves  
12 the compromise of any claims to the prepaid interest collected  
13 by the debtor post-petition -- and maybe I should go back and  
14 explain again. I know we had this discussion last Friday  
15 about prepaid interest but maybe since Judge Pro was not here  
16 let me kind of explain what this is.

17 What happened in this case is that prior to the time  
18 the bankruptcy was filed there were all kinds of what I'll  
19 call "irregularities" in the servicing. And --

20 JUDGE PRO: I can save you some time. I did read  
21 through your --

22 MS. JARVIS: You did read it? So you understand the  
23 prepaid interest --

24 JUDGE PRO: -- your brief last night so I am  
25 familiar with the pyramid scheme, if you will.

1 MS. JARVIS: Yeah.

2 JUDGE PRO: The scenario that took place previously.

3 MS. JARVIS: The diversions and the payment  
4 basically to people of interest that was never collected from  
5 their borrower --

6 JUDGE PRO: Right.

7 MS. JARVIS: -- or from other people's funds,  
8 basically.

9 JUDGE PRO: Right. Simply other investments that  
10 were made, were used to --

11 MS. JARVIS: Right. And so -- so when we talk about  
12 collecting back prepaid interest we're talking about --

13 JUDGE PRO: Something we see all too often,  
14 unfortunately, in other contexts too.

15 MS. JARVIS: Well, unfortunately, we see it a  
16 lot in bankruptcy.

17 JUDGE PRO: Mm-hmm.

18 MS. JARVIS: So when we talk about collecting  
19 prepaid interest, we're talking about recouping back this  
20 interest that the debtor previously advanced to these parties,  
21 that they were never entitled to be paid, in fact were paid in  
22 violation of Nevada law.

23 The -- with respect to this prepaid interest, the  
24 Lender Protection Group are not a person aggrieved because  
25 they failed to preserve their rights with respect to this



1 issue. No evidence was presented at the trial court as to any  
2 specific claim of any of these lenders to these funds held by  
3 the debtors. They talk about these as segregated funds and  
4 yet there is no evidence that any of these lenders have any  
5 specific rights to these, quote, unquote, "segregated funds".  
6 No evidence was presented below to establish that. Either as  
7 collective prepaid interest claims that belong to these  
8 individuals --

9 JUDGE PRO: Let me just ask in that regard. As I  
10 recall, the appellants take the position this is a legal  
11 argument, we didn't have to offer evidence, it's -- if you're  
12 going to be taking money out of our pocket, in essence,  
13 there's a pecuniary impact and we are, hence, person  
14 aggrieved. How do you -- how do you respond to that?

15 MS. JARVIS: Well, there are two things. The first  
16 one is, you know, I think very clear, which is, there is a  
17 claim that if you had diverted principal, meaning some of the  
18 principal that got poured into this pot and paid out to  
19 everyone else, so you have some -- a special claim on this  
20 prepaid interest. The -- you know, evidence was presented  
21 that these funds were commingled. There was no tracing. In  
22 fact there was a concession on the record by Mr. Smith that he  
23 agreed, that no tracing could be done. So that these funds  
24 were not traceable and, therefore, since there was no way --  
25 no specific interest claimed in these funds, then that was



1 waived because -- or they didn't pursue their interest because  
2 they presented no evidence showing that this gave them any  
3 special claim, these diverted principal claims, to the  
4 segregated funds; to the funds that the debtor is holding and  
5 recouped the prepaid interest.

6 JUDGE JONES: Now, one little subset of that though  
7 is, the funds that were collected post-petition were collected  
8 and put into an account with an understanding in the order, as  
9 I understand it, that they would be segregated. In other  
10 words, their nature would not be changed. So that order, of  
11 course, can't change the nature of those funds and can't make  
12 them specifically traceable if they're not. But at the same  
13 time, it means that they -- they aren't waiving a commingling  
14 argument on the post-petition fund. So with respect to the  
15 post-petition funds that were collected as opposed to the pre-  
16 petition, can they not, in fact, claim that tracing is  
17 available?

18 MS. JARVIS: And that's the second piece, which is  
19 -- you know, the diverted principal claims and claims on these  
20 funds is one thing. The second is, the recoupment rights that  
21 the debtor had, you know, exercised pursuant to the plan that  
22 deals with some of the funds that were held back to recoup  
23 back these claims. But, again, no evidence was presented as  
24 to any -- identifying any part of the segregated funds that  
25 the debtor held that -- that they were objecting to or

1 believed that was being compromised. So there simply was no  
2 evidence, you know, presented.

3 Let me read -- perhaps it would be helpful, Your  
4 Honors, to read from the Court's record below, because the  
5 Court did determine -- looked at this very issue and  
6 determined that in fact they had not pursued their rights.  
7 They had not preserved those rights. And let me read from  
8 page 220 of the transcript on December 19<sup>th</sup>, what the Court  
9 said about this, and I'll quote.

10 "Now, I think Ms. Jarvis did an excellent job. A  
11 lot of cases in this area are ah-ha cases. These are  
12 cases where, again I apologize to people who don't do  
13 bankruptcy, they're the Chapter 13s where people are  
14 trying to get discharged by declaration. And that is,  
15 that people are trying to sneak something through in the  
16 plan. That people haven't had an opportunity to be heard  
17 and people say ah-ha, I avoided your security interest,  
18 or, ah-ha, I canceled a portion of your lien. Nothing  
19 like that is happening here.

20 "A compromise on a ripe payment that occurred pre-  
21 petition, that they've known about since the beginning of  
22 the case is being compromised. We have heard repeatedly  
23 -- we've heard that -- two or three people say we were  
24 promised things. We were promised a proceeding. This is  
25 the proceeding. We were crystal clear that the

1 proceeding could be in the context of a plan. The plan  
2 and the disclosure statement --

3 JUDGE JONES: She's talking about the potential of a  
4 separate adversary proceeding.

5 MS. JARVIS: Right. Right, that somehow we took  
6 away -- that the plan took away some claim to funds, these  
7 funds that were determined to be property of the debtors by  
8 virtue of the plan, whether this was properly done and whether  
9 anything -- whether they had in fact preserved their rights to  
10 this. And, in addition, whether we had to file an adversary  
11 proceeding which she found we didn't.

12 "The plan in the disclosure statement, since they  
13 were filed, are crystalline on the issue that  
14 confirmation is being imposed, and yet we don't have any  
15 conflicting evidence on the compromise. We don't have  
16 any efforts to take discovery of the debtor to make sure  
17 they are contradicting any of these facts. We don't have  
18 any contentions that the payments, when made, were not  
19 consistent with the contract and were in fact illegal.  
20 What we do have is saying, well, we have undisclosed  
21 defenses. They can come and sue all four thousand of us,  
22 and that's clearly not what the code requires."

23 So the court below, actually, in -- in looking at  
24 this issue in an -- in approving this compromise, and the  
25 compromise includes the issues with respect to this prepaid

1 interest and the recoupment of it, found that they had not --  
2 these parties had not pursued their rights. Had not preserved  
3 them below. And that is a basis of standing on appeal.  
4 Because of that, they do not have standing on appeal.

5 Let me turn to the second issue which in some ways  
6 is a subset of the first. Because if you look under Section  
7 4(e)1(B) of The Direct Lender USACM Compromise in the plan,  
8 the compromises are well set out in the plan. It says --  
9 there's a section which is entitled "Loan Servicing  
10 Agreements," and it says:

11 "All rights of USACM as servicer under the loan  
12 servicing agreements, transferred -- are transferred  
13 without modification, pursuant to the plan, and the asset  
14 purchase agreement shall be free and clear of all liens,  
15 claims, interest, obligations and encumbrances whatsoever  
16 under Sections 363."

17 JUDGE JONES: Well, let me stop you there.

18 MS. JARVIS: Mm-hmm.

19 JUDGE JONES: 'Cause the latter clause is going to  
20 be very important.

21 MS. JARVIS: Okay.

22 JUDGE JONES: But that former clause is "without  
23 modification". In other words, they're transferred free and  
24 clear but without modification.

25 MS. JARVIS: Right. That's correct.

1 JUDGE JONES: The terms are as they are.

2 MS. JARVIS: Right. Correct. But they're  
3 transferred under 363 and 1123. And that's the end of this  
4 sentence. So part of the compromise --

5 JUDGE JONES: Go ahead and finish it. I'm sorry.

6 MS. JARVIS: Right. Part of the compromise was that  
7 these loan servicing agreements are transferred without  
8 modification, free and clear of all liens, claims and interest  
9 under 363 and 1123 of the Bankruptcy Code and any other  
10 applicable sections of the Bankruptcy Code.

11 Now, there was the one concession that was made with  
12 respect to this provision at the confirmation hearing. The  
13 one I just described to you made by Compass. So that, you  
14 know, modified this, but modified it in a good way.

15 JUDGE JONES: So otherwise the effect of that order  
16 though is, that there's no breach. The Bankruptcy Court is  
17 declaring there's no present breach in these contracts by the  
18 debtor?

19 MS. JARVIS: No. What the Bankruptcy Court  
20 determined is, that under applicable law -- Ninth Circuit  
21 law, the contracts are not executory, because there aren't --  
22 while there are remaining duties on the side --

23 JUDGE JONES: In an executory contract the debtor  
24 has to cure any breaches --

25 MS. JARVIS: Right.

1 JUDGE JONES: -- before it can sell.

2 MS. JARVIS: Right. But these are not. And, in  
3 fact there is the Quintex case in the Ninth Circuit where the  
4 same thing was done. Contracts that were not executory were  
5 sold under 363. And --

6 JUDGE JONES: So the court is saying these aren't  
7 executory contracts that require any cure; does the judge  
8 go further though and say there is no breach in these  
9 contracts?

10 MS. JARVIS: No.

11 JUDGE JONES: No.

12 MS. JARVIS: What she said is, if there are any  
13 claims, they will be claims against the bankruptcy estate.

14 JUDGE JONES: So she is severing any claims for  
15 breach?

16 MS. JARVIS: Right.

17 JUDGE JONES: She is severing any claim for breach  
18 of the contract from the contract itself that goes to the  
19 servicer, any claimant for a breach has to look back at the  
20 Bankruptcy Court. It can't look to the servicer.

21 MS. JARVIS: Because that's part of selling those  
22 contracts free and clear. And the one exception is the  
23 concession made, you know, by Compass at the hearing which  
24 is, breaches that occurred -- mature breaches, pre-petition,  
25 could be used for changing servicers if they meet provisions

1 of the contract. But other than that, they were sold free and  
2 clear.

3 And so, consequently, if The Lender Protection Group  
4 failed, as they did, to preserve their rights with respect to  
5 the compromise, the judge specifically found that they did not  
6 present any evidence to preserve their rights in contradicting  
7 the compromise; then they failed to preserve this [sic] rights  
8 on this issue as well because it was included in the  
9 compromise.

10 Further, they -- The Lender Protection Group failed  
11 to present any evidence or create any record at the trial  
12 court. They would suffer any direct pecuniary harm as a  
13 result of these transfers.

14 JUDGE JONES: Now, why -- I don't quite understand  
15 this last argument.

16 MS. JARVIS: Mm-hmm.

17 JUDGE JONES: They are -- they did object legally.  
18 They said Judge Riegler made a mistake when she ruled that  
19 these aren't executory contracts. And isn't that just a pure  
20 legal issue and they made the objection, and so clearly they  
21 preserved their right to appeal the ruling.

22 MS. JARVIS: Well, I think there are two issues. I  
23 mean, there -- you can -- if you separate it off, that is one  
24 issue, but the other issue is it's actually part of the  
25 compromise. So the compromise -- because the compromise